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IN THE

Supreme Court of the United States

October Term, 1972
No. 72-454

ESTATE OF WALBURGA HEDRICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONER'S REPLY BRIEF.

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Statement.

The statement set out in Respondent's brief is generally correct in supplementing petitioner's statement. There should be added however, to the third line on page 5, that the amortization schedule at seven percent, provided for the seven percent interest to be "compound interest" on assumed unpaid interest as established by respondent, said assumed interest being in excess of the provided for installment payments in the contract.

Questions Presented.

The questions presented are set out in the opening brief. In Respondent's brief, only two of those questions are mentioned, and the important question upon which the opinion of the Court of Appeal is entirely based, to-wit "Is the Tax Court opinion the Law of the Case" is omitted either in the category of Questions Raised or in the argument.

Constitutional Provisions and Statutes Involved.

These have been set out in the opening brief by petitioner.

ARGUMENT.

Replying to Respondent's brief in opposition, petitioner respectfully calls attention to the erroneous assumption of fact, evidence, and record to support his argument, and that argument is based on such erroneous postulate, as hereafter set out. In addition thereto, petitioner calls attention to the fact that on a number of questions presented by petitioner, which he believes to be important, there is no answer or refutation, included in which are the following and upon which we do not submit extended argument for the reason that it has been covered in the opening brief. These points not refuted are:

1. That the decision of the Court of Appeals is not in conformity with existing law and that petition should be granted to obtain conformity on important questions set out in the petition,

2. That the change in legal climate contended by Respondent is for conforming to the Wilshire case (*Wilshire v. Comm'r.*, 262 F.2d 51) the opinion in which is the result of misinformation and misrepresentation to the court as to the record in the case by its counsel,

3. That the decision of the Court of Appeals by affirming the Tax Court approves a decision in violation of the Constitution of the State of California relating to usury,

4. That the decision of the Court of Appeals in reaffirming the Tax Court, approves disregard of state statutory law and the Internal Revenue Code.

5. That in approving the Tax Court decision, the Court of Appeals, approves retroactive application of law, ex post facto law, and a violation of due process,

6. That approval of the Tax Court decision by the Court of Appeals totally disregards the statute of limitations,

7. That a denial of the granting of this petition will result in a multiplicity of suits for the reason that respondent has filed another assessment and the matter is now in the Tax Court (Docket 362370) covering the years 1966, 1967 and 1968 on the same source of income, which will be disposed of by the granting of petition herein but by reason of additional questions included in said proceeding, will require further adjudication if this petition is denied.

Among the questions not replied to is the sole and only point on which the Court of Appeals in the latest appeal in No. 26292 affirmed the decision of the Tax Court after reversal by the said Court of Appeals in #20005 of the previous decision of the Tax Court, and the new trial by the Tax Court after such reversal, is the question: Is the Court of Appeals correct in stating that the decision of the Tax Court in pursuance of Court of Appeals decision in #20005, has become the law of the case so that the appeal of petitioner has become moot. The authorities, as cited in the opening brief, hold that it is not, and indicate that the decision of the Court of Appeals is not in conformity with the law as uniformly stated in numerous decisions. (P. 20, Note Opening Brief.)

This question being the sole reason given for affirmance of the Tax Court decision, it becomes para-

mount. In view of the prior reversal, the complete retrial of the matter, with new evidence, new witnesses, and new issues and new decisions, not to disturb the opinion of the Court of Appeals in holding that a prior decision is the Law of the Case, would result in a great divergence from the existing law on the subject. The respondent in failing to reply to the question presented is a failure to question the merits of the point raised.

The first point replied to is that *Oesterreich v. Comm'r.*, 226 F.2d 798 is not collateral estoppel in assessing for later years. Practically all of said argument is directed to the argument that the rule is that manner of assessment for one year does not bind the commissioner for assessing differently for later years where there is a change of circumstances or change of legal climate. We do not believe that the rule applies in this instance where there was no change in circumstance and the change in legal climate contended by respondent is not applicable here: (1) the supposed change in legal climate in computing the basis for tax assessment is computed from more than thirty years prior (1929) to the said "change in legal climate" (*Wilshire v. Comm'r.*, 262 F.2d 51) in 1961; (2) that the income affected is a single continuing contract; (3) that the Court of Appeals (226 F.2d 798) in *Oesterreich*, has determined the tax treatment of the income on the whole contract and not for individual years only; (4) that *Wilshire v. Commissioner* (262 F.2d 51) as noted in the opening brief is a decision resulting from misinformation by Wilshire counsel to the court as to the state of the record in the litigation, upon which the court acted, and that it is improbable that the court would have made the same decision for

Wilshire if the court would not have such misinformation before it.

However to conform to the opinion of the Court of Appeals in remanding the case back to the Tax Court, the issue was abandoned in the latest hearing before the Tax Court and the appeal in the Court of Appeals and not further pursued. However, the argument in Respondent's brief is to the issue that determination of tax liability as to one year does not necessarily bar the Commissioner from assessing differently for later years when there is a change of circumstance or "legal climate". As to that there is no issue. The question previously raised is whether it is applicable in this instance. The cases cited by Respondent are therefore not pertinent here.

The only portion of respondent's argument on this subject that is not against a strawman and has any pertinence to the issue presented is the last paragraph on page 7 and completing on the top of page 8, wherein he says:

"While not claiming a vested right in perpetuity to the tax treatment set out in the *Oesterreich* opinion, petitioner seeks to establish a vested right in that treatment until the date on which the legal atmosphere changed."

Petitioner does not dispute that statement, but no reason is given why petitioner is not correct in being entitled to the benefit of *Oesterreich* until there is a circumstance or a change of legal climate, excepting to state that none of the years determined by *Oesterreich* (226 F.2d 798) in 1955, are barred from reconsideration in 1960 by the Statute of Limitations which is not an answer to the question of estoppel. As a reason why it

is not barred respondent cites I.R. Code Sec. 6501, but Sec. 6501 does not support him. It does however reinforce petitioner's position on the Statute of Limitations that any assessment made after three years of receipt of income is barred, here it goes back from 1929 to 1960—31 years. In addition to the Int. Rev. Code, as cited in the opening brief, the contended assumed indebtedness on which the assessment is made is barred by California statute after four years (California Code of Civil Procedure, Sec. 336). The Section of Int. Rev. Code cited by Respondent (6501) reads as follows:

> "SEC. 6501 LIMITATIONS ON ASSESSMENT AND COLLECTION
>
> (a) General Rule—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within three years after the return was filed (whether or not such return was filed on or after date prescribed), or if the tax is payable by stamp, within 3 years after such tax become due, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period."

On page 9 of his brief, Respondent refers to Sec. 483 of the Internal Revenue Code in his paragraph 3, which provided that where interest is not stated in a realty sales contract that in proper cases, the commissioner may include an interest charge up to five percent. This provision was enacted in 1964 and no mention is made in the answer to the point raised by the petitioner that application of this section as well as the Wilshire case which became final in 1961, to income from 1929 to 1960 is retroactive, *ex post facto,* and a violation of due process. The question of due

process raised by petitioner is one that this court is ordinarily very much interested in, yet there is no word from respondent why that constitutional right should not be considered by this court. Retroactive application of new law has consistently been held to be a violation of due process and has only been permitted where the new law specifically provides for it and then only for a reasonable period, held to be "reasonable" when such period is less than a year to include the beginning of a yearly accounting period, and certainly not for a period of thirty-one years.

Robinson v. Commissioner, 439 F.2d 767;
Shanahan v. United States, 477 F.2d 1082.

The second point answered by respondent is the proper application by the commissioner of the installment payments to principal and interest. As will be pointed out hereinbelow, the entire argument is based on fallacious postulates and presumptions not borne out by the record, for example he says:

> "Each scheduled payment was first applied to interest then to principal in the fashion of a normal mortgage financing arrangement. The seven percent interest rate utilized in the calculations comports with both the rate of interest the parties themselves agreed would apply to overdue payments and to the rate of interest on judgments under the applicable state law."

This statement is incorrect. The only places where a rate of interest is referred to in the lease in question is with reference to advancement of money to redeem the property from failure of Wilshire to pay property taxes when due, in which event petitioner is

to be reimbursed for the moneys advanced together with interest at seven percent per annum, and has no reference to installment payments, or compound interest and provides as follows:

> "Any such amounts so paid by Lessor shall become due and payable by Lessee to Lessor at or before the next rent day after such payment by Lessor together with interest thereon at the rate of 7% per annum from date of payment by Lessor until paid by Lessee".

The other reference to interest in the Agreement refers to the maximum rate of interest the first trust deed to which Lessor subordinates his title, may bear, reading:

> "The trust deed hereinbefore referred to shall bear interest at a rate of not to exceed 7% per annum, payable quarterly, and shall by its terms be amortized at a rate of not less than 5% per annum after the first two years from date."

Also referring to the above quoted paragraph from Respondent's brief, (p. 8) it is also untrue that as stated that from each payment application was made first to interest and then to principal. The record is undisputed as stated in the opening brief that in Respondent's computation that for the first ten years nothing was applied to principal but that an assumed principal or purchase price and an assumed rate of interest was established by respondent so that whereas the monthly installment payments provided for in the agreement and so paid was $625.00, the interest supposed to be earned was $750.00 resulting in an assumed unpaid indebtedness of $125.00 monthly and interest on said

assumed unpaid indebtedness was compounded from year to year, so that by the year 1942 Wilshire was supposed to owe petitioner $24,000 in unpaid interest in addition to the original amount of assumed principal. The original portion of the actual purchase price of $679,380.00, assumed by respondent to be the principal was approximately $138,000; by reason of assuming an interest rate on the assumed principal to be in excess of the provided-for installment payments which were paid in conformity with the agreement, the computation resulted in the year 1942 to be a principal on which interest was further compounded, to be $162,000, and though not actually owed, paid or received, was assessed yearly and said assumed, unpaid and not received interest was compounded from year to year, and on that manner of computation, this claimed liability of petitioner was assessed and is the basis of this proceeding. This state of the record does not conform to the quotation above from Respondent's brief, and it is apparent that respondent's counsel who prepared the brief is very unfamiliar with the record in this case and makes argument based on erroneous assumption of facts. Another example of his unfamiliarity with the record is the statement on page 9, note 2 stating:

> "Quite apart from the fact that petitioner as the recipient of compounded interest, is hardly in a position to assert Wilshire's objections to that interest, the schedule of payments to which the parties agreed implicitly provides for compounding."

It is very difficult to ascertain from where respondent arrives at such a statement. As stated by respondent in the said note 2, p. 9 the law permits compound-

ing of interest when agreed to in writing, but not only does the Agreement not state that interest on installments paid or unpaid may be compounded, but there is no reference to interest in the agreement, as to late payments at all, even if there were late payments which there were not.

From where respondent gets his assertion in the above quotation that the petitioner was the recipient of compound interest, is hard to fathom. It is not only not a fact but there is nothing in the record to even intimate it.

The erroneous assumption of fact, record or evidence is acerbated by the statement on page 9 that petitioner can make no complaint because the agreement to pay interest is in writing and therefore the California constitution is not violated. Nothing is further from the fact or the record. If there were any writing providing for the payment of interest, our whole issue of the use of usurious interest in respondent's computation would be moot. Respondent says on page 9 with reference to the application of seven percent compound interest "Nor can petitioner point to any decision in conflict with the holding below." Of course we do not contend that such interest is unlawful or usurious when stated in writing, *but there is no writing agreeing to pay any interest.* The statement on page 9, Note 2, above quoted, about not being in position to assert Wilshire's objection to payment of interest is indeed very confusing. Wilshire has had no occasion to object, or petitioner to assert such objection for Wilshire, nor has Wilshire objected to being credited by the commissioner in being allowed a tax write-off of interest in the sum of $9,000 per year when total installment payments were $7,500. It's all very bewildering to this writer.

All contention by respondent that the assessment is proper and in conformance with the agreement between the parties, goes up in smoke with his own statement which has the effect of stating that the computation was designed to bring about a predetermined result rather than a compliance with the contract when he says on page 8:

> "This schedule was derived by applying an interest factor to the schedule of payments set out in the 'lease' and working backwards over the term of the lease."

This statement is correct and exactly what petitioner has pointed out in the opening brief, to-wit: that the actuary for the government who testified in the first tax court trial and the actuary who testified for the government in the second trial, testified that they were to establish a fictitious principal and an assumed interest starting back from 1929, so as to achieve the desired result.

Conclusion.

This is an unusual case with unusual proceedings. As pointed out the argument of respondent is based on spurious presumptions of fact, evidence and record. A great and gross injustice to petitioner would result if the decision of the Court of Appeals should become the final Law of the Case, after twenty years of litigation, covering assessment based on computation for years from 1929 on, and on which full one hundred percent tax has already been paid on income as ordinary income up to the time of beginning of this litigation in 1948. The law as enunciated by the Court of Appeals is not in conformity with the law as stated by the various circuits of the Court of Appeals or

this court. There has been a failure of due process in retroactive application of a 1961 decision (*Wilshire*) and a 1964 statute (Sec. 483 of Int. Rev. Code) to income beginning with 1929, which had heretofore been fully paid. We respectfully submit that fairness, justice and maintenance of proper conformity and continuity of the law merits a hearing by this court.

Respectfully submitted,

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